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COMMERCIAL LAW

I. CONTRACT FORMATION

A. *Intent*

In the case of *Household Utilities, Inc. v. Andrews Co.*,[1] the Wisconsin Supreme Court reviewed the requisites of contract formation. The defendant was a contractor which had been awarded a contract for the construction of a heating facility. In drafting its bid, Andrews had included figures from the plaintiff's subcontracting bid. After Andrews was awarded the contract, it informed Household that the latter had been the low bidder for the subcontracted portion of the project. There followed considerable correspondence between the parties relating to the project,[2] including a request made by Household to Andrews for the issuance of a purchase order. Household was thereupon sent a photocopy of a purchase order which described the work to be done, listed the bidded price, and was signed by the head of Andrews's heating department.

Subsequently, Household informed Andrews that its subcontracting costs would be more than the amount of the original bid, and the bid was changed accordingly. However, by April 1972, Andrews had sold its heating department and was evincing a desire to assign the contract for the project. Moreover, Andrews informed Household that it would not honor commitments made regarding the project.

Household had ordered various materials for the project by this time and commenced suit against Andrews to recover the costs thereof. The case was tried without a jury and the trial court held, at the close of the plaintiff's case, that "there had been no meeting of the minds on the contract as evidenced by

1. 71 Wis. 2d 17, 236 N.W.2d 663 (1976).

2. A time table of this correspondence would appear as follows:

Dec. 9, 1971: Household submits its subcontracting bid to Andrews.

Dec. 20, 1971: Andrews is informed that its contracting bid has been accepted; it in turn notifies Household of its acceptance of the latter's subcontracting bid.

Dec. 22, 1971: Household's manager sends written confirmation of the bid to Andrews.

Dec. 27, 1971: Andrews requests clarification of the bid from Household.

Dec. 31, 1971: Household sends clarifying information.

Jan. 1972: Household requests purchase order from Andrews.

Id. at 18-19, 236 N.W.2d at 664.

3. The issuance of a purchase order is a common method by which subcontractors are hired by contractors.

. . . a letter from the plaintiff to the defendant, in which the plaintiffs requested a new purchase order . . . to correct an error."[4] The defendant moved for and was granted a nonsuit.

On appeal, the court reiterated several basic rules of contract law. First, the burden of establishing the existence of a contract is on the person attempting to recover for its breach.[5] To do this, he must show that there was a meeting of the minds between the parties. Thus, the second rule is that "[t]here is no meeting of the minds where the parties do not intend to contract and the question of intent is generally one to be determined by the trier of fact."[6] The trier of fact is to determine the intent of the parties by considering their words, both oral and written, and their actions.

The court affirmed the holding of the trial court, pointing to the correspondence between the parties as support of the trial court's conclusion that there was never any reasonable certainty with respect to the basic terms and conditions of the alleged contract.[7] If the words and actions of the parties evince uncertainty and inconclusiveness with regard to material terms of the contract, the proponent of the contract has failed to meet its burden, and no contract will be found.

The intent of the parties to a contract was also at issue in *Peterson v. Schrieber*.[8] The plaintiff in this case contracted with the defendant for the construction of a prefabricated building. The parties agreed that the defendant would supervise construction, lay a concrete floor, and erect the building. This contract was formed in June, and partial payment was made to the defendant in July. Also in July, the plaintiff brought in fill to grade the site properly. However, the defendant was not available to supervise the preparations, and it was not until October that the defendant arranged for the foundation to be laid by a third party.

In October, Schrieber obtained a performance bond from Fidelity and Deposit Company of Maryland. Further difficulties plagued the construction until Peterson finally terminated the contract and made other arrangements for construction in December.

4. 71 Wis. 2d 23, 236 N.W.2d at 666.
5. *Id.* at 28-29, 236 N.W.2d at 669.
6. *Id.* at 29, 236 N.W.2d at 669.
7. *Id.* at 30, 236 N.W.2d at 670.
8. 71 Wis. 2d 498, 238 N.W.2d 722 (1976).

At the trial, the court found that Schrieber had breached the terms of the contract by its failure of performance both prior and subsequent to obtaining the performance bond from Fidelity. The trial court therefore entered judgment for the plaintiff for damages arising throughout the life of the contract.[9]

The intent of the parties to the surety contract was at issue on appeal. The supreme court followed the rule that "a contract of suretyship is not retrospective in its application and that no liability attaches to the surety for defaults occurring prior to the date of execution of the performance bond."[10] Finding no evidence in the record to indicate that Fidelity had any knowledge of Schrieber's defaults or near defaults at the time of the bond's issuance, and thus no intent to assume the liability for such breaches, the court concluded that the surety could not be held liable for damages arising prior to that date.[11] However, the court concurred with the trial court that the breaches giving rise to damages to which Fidelity was being held liable occurred after the bond's issuance, and affirmed the decision.

The case of *Titus v. Polan*[12] involved a merchant's small claims action for the price of a submersible pump motor. In November 1973, the plaintiff sold a submersible pump to the defendant. When the pump motor failed the following August, the defendant called the plaintiff to have it repaired. The plaintiff, upon inspecting the pump, concluded that a manufacturing defect existed, replaced the pump motor and returned the original motor to the distributor. The defendant was not billed for the replacement motor until the distributor declined to honor the warranty.

The evidence introduced at the trial indicated that the pump motor was designed to be operated at 220 volts. The testimony of the plaintiff and the defendant conflicted as to the

9. The trial court entered judgment against Schrieber and Fidelity for $13,382.36, $7,645.44 of which represented the plaintiff's liability to the third party who had actually laid the concrete flooring. The remainder reflected damages suffered by the plaintiff in securing a replacement building. The trial court also entered judgment against Schrieber alone for payments made to the defendant at the contract's inception. *Id.* at 501, 238 N.W.2d at 724.

10. *Id.*

11. The court likened surety bonds to insurance contracts, and cited Reed v. Maryland Cas. Co., 244 F.2d 857 (5th Cir. 1957) for the proposition that, "for practical purposes these suretyship contracts are much like contracts of insurance, whereby the insurer will assume the risk only of future occurrences but not of past and established ones." *Id.* at 502, 238 N.W.2d at 724-25.

12. 72 Wis. 2d 23, 240 N.W.2d 420 (1976).

voltage at which the motor was actually operated, but it was established that a motor designed for high voltage would operate for only a short period of time at a lower voltage. In this instance, the motor was operated for seven months.[13]

Based upon the fact that the defendant requested the repair of the motor and upon other circumstances surrounding the transaction, the trial court concluded that an agreement to pay for the new motor had been made by the defendant, that the plaintiff had given no warranty as to the performance of the original motor, and granted judgment to the plaintiff.

The supreme court reversed on appeal, finding that no express contract to pay for the replacement motor had been proven by the plaintiff.[14] The court also declined to find an implied agreement to pay for the replacement motor. Citing the recent case of *Hicks v. Milwaukee County*[15] for the proposition that recovery in quasi-contract is allowed when the plaintiff has conferred a benefit on the defendant and when it would be inequitable to allow the defendant to retain the benefit without paying for it, the court concluded that the circumstances surrounding this transaction did not support a conclusion that it would be inequitable to allow this defendant to retain the benefit of the replacement motor.

This conclusion was reached by the court's application of the warranty provisions of the Uniform Commercial Code. Citing section 402.314 of the Wisconsin Statutes,[16] which implies a warranty of fitness for the ordinary purpose for which the goods are used, and pointing to the plaintiff's failure to show

13. *Id.* at 24, 240 N.W.2d at 421.

14. While the court indicated that the defendant's request of the plaintiff to service the motor was relevant to the question of an agreement to pay, the court concluded that this fact alone did not require such a finding in light of the plaintiff's failure to bill the defendant for the motor and installation charges until the distributor declined to honor the manufacturer's warranty. Moreover, the court noted that no testimony was introduced to show that the defendant was informed of the problem with the motor and had agreed to pay for its replacement. *Id.* at 25, 240 N.W.2d at 421-22.

15. 71 Wis. 2d 401, 404, 238 N.W.2d 509, 512 (1976).

16. WIS. STAT. § 402.314 (1973) provides:

(1) Unless excluded or modified . . . a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as:

. . .

(c) Are fit for the ordinary purposes for which such goods are used.

that such warranty was excluded or modified, the court concluded that the existence of this statutory warranty precluded a finding of inequity in allowing the defendant to retain the benefit of the replacement motor.

B. Consideration

In *Estate of Mingesz*,[17] the court considered the sufficiency of evidence to establish a guaranty contract. Here, Richard Mingesz signed a statement which guaranteed the payment of a note executed nine months previously.[18] The note was payable in full in September 1969. Mingesz died in November 1970, and the payee of the note subsequently filed a claim against his estate for the full amount of the note plus interest.

The first defense raised by the guarantor's estate was that no consideration had been given to Mingesz. Testimony of the attorney who drafted the document indicated that no pecuniary consideration passed to Mingesz at the signing.[19] However, the court, citing a century-old Wisconsin case[20] for the proposition that the recitation of consideration received in a guaranty is sufficient to raise the presumption that consideration was given in fact, found this testimony insufficient to rebut the presumption.[21]

The estate also argued that the failure of the creditor to give notice to the guarantor of its acceptance of the guaranty absolved the guarantor of liability. The court rejected this argument, holding that "notice of acceptance is not required where the guaranty is an unconditional agreement to pay a fixed, previously incurred debt."[22] Here, the guarantor knew precisely the full amount due on the note and the extent of his liability when the guaranty was executed. There was no doubt that Mingesz intended to guaranty that amount.[23]

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17. 70 Wis. 2d 734, 235 N.W.2d 296 (1975).

18. The statement signed by Mingesz read as follows:

> *For value received,* I, the undersigned, guarantee the payment of the above described note in full and if after the maturity of this note the maker does not pay the full principal and interest then due and owing thereon, the undersigned will, on demand of the holder hereof, pay the holder any and all sums then due and owing.

Id. at 736, 335 N.W.2d at 297 (emphasis added).

19. *Id.*

20. Yenner v. Hammond, 36 Wis. 277, 280-81 (1874).

21. 70 Wis. 2d at 741, 235 N.W.2d at 300.

22. *Id.*

23. The court distinguished the case of Miami County National Bank v. Goldberg,

II. CONTRACT INTERPRETATION

A. *Time of the Essence Provisions*

The court was called upon to determine if time was of the essence to a mortgage loan commitment in *Gonis v. New York Life Insurance Co.*[24] The plaintiff, seeking refinancing of a shopping center, accepted a commitment for a mortgage loan from the defendant. The closing date was set for April 15, 1972. In the two months between the acceptance of the commitment and the projected closing date, much correspondence passed between the parties in their efforts to fulfill the conditions precedent to the loan.[25] When the date of closing neared, however, the plaintiff suggested that it be extended. No response to this suggestion was made by the lender before the closing date, nor was the closing held at the scheduled time. The plaintiff thereupon rescinded and brought suit for money paid to the defendant as an application and processing fee and security deposit.

The court looked to both the terms of the contract and the actions of the parties to determine that time was of the essence. Although the contract did not state that time was of the essence,[26] it provided that $26,000 in liquidated damages were to be paid to the lender if it did not receive the loan on or before the expiration of the commitment, that the lender's obligations

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133 Wis. 175, 113 N.W. 391 (1907) from the instant case by reason that, in the former, where the court had held the guarantor entitled to notice of acceptance as a condition precedent to his liability, a guaranty of future, and thus not fixed, liability was involved. This distinction, and the conclusion of the court in the instant case, seems in agreement with the court's decision in Peterson v. Schrieber, 71 Wis. 2d 498, 238 N.W.2d 722 (1975), wherein the court concluded that a surety could not be held liable on a bond for breaches of the principal contract which occurred prior to the bond's issuance, and of which the surety had no knowledge or intent to insure. *See* text accompanying notes 8-11 *supra*.

24. 70 Wis. 2d 950, 236 N.W.2d 273 (1975).

25. The financing was conditional upon the borrower's providing the lender with tenant's acceptance and estoppel letters, assignments of the lessor's interests, a survey of the premises and a title report, proof that adequate hazard insurance policies had been obtained, and various other certifications by the borrower. The correspondence between the parties during this time, however, centered basically around the sufficiency of the survey and the title report. *Id.* at 952-53, 236 N.W.2d at 274-75.

26. The lender argued that the absence of any oral or written agreement making time of the essence was a factor to be weighted heavily against a finding that it was essential. The court disagreed, and stated that the lack of such an agreement "does not preclude evaluating the circumstances arising from the acts of the parties as to whether time was, in fact, considered by them to be of the essence." *Id.* at 956, 236 N.W.2d at 276.

under the commitment ceased after the day of the closing, and that any extension of this date was in the sole discretion of the lender and was to be made only in writing.[27] If only because of the possibility of losing the liquidated damages, time appeared to be of the essence. Moreover, the failure of the lender to respond to the borrower's suggestion that the closing date be extended prompted the court to affirm the trial court's conclusion that such nonaction was indicative of the parties' belief that time was in fact of the essence to the financing. Silence by the lender to this suggestion, in view of the various provisions of the commitment, would hardly seem to indicate to the borrower that time was not of the essence.[28]

Finding that time was of the essence to the commitment agreement, the court then held that the borrower had not breached the contract by failing to meet its conditions precedent. The trial court had found that the "conditions . . . could have been completed within the time limitations of the original application closing date."[29] The court agreed and stated that the failure of the borrower to fulfill the conditions prior to the time of closing did not constitute a breach of the commitment absent a showing that such conditions would not have been met had the closing been held as planned:

> Viewing the duties listed as conditions precedent, we agree with the trial court that, where the respondent could have fulfilled the conditions by or on the original closing date, his not having done so earlier is not controlling where a closing was not attempted on the closing date, or such closing date was extended.[30]

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27. *Id.* at 955-56, 236 N.W.2d at 276.

28. *Id.* at 956-57, 236 N.W.2d at 276.

29. *Id.* at 958, 236 N.W.2d at 277.

30. *Id.* at 960, 236 N.W.2d at 278 (footnotes omitted). It is interesting to note that with respect to the obtaining of hazard insurance, the court recognized the common practice of using funds derived from the lender to pay the premiums thereof. To this effect, the court cited 6 S. WILLISTON, CONTRACTS, § 881 at 387-88 (3d ed. 1976):

> A mortgage can be drawn from the buyer to the lender before the land is conveyed; then if the buyer and seller and lender meet at the same place, the seller can be paid his money while simultaneously he delivers a deed to the buyer, and the buyer delivers a mortgage to the lender. In the same way, if the buyer's money is needed to free the title which the seller must offer, a simultaneous execution of the transaction is possible if the person holding the title or encumbrance is willing to aid the seller in carrying out the bargain, and this should be sufficient.

Thus, because time was found to be of the essence to the agreement, and because the date of closing had passed without a breach of its terms on the part of the borrower, the court affirmed the trial court's finding that the borrower was entitled to rescind the agreement.

B. Mortgage Interest Escalator Clauses

The court was twice called upon to determine the validity of a mortgage interest rate escalator clause this term. In the first case, *Security Savings & Loan Association v. Wauwatosa Colony*,[31] the court validated escalation clauses in mortgage agreements with Wisconsin savings and loan associations and further held that such provisions could be exercised more than once. In the second case, *Kaski v. First Federal Savings & Loan Association*,[32] the court invalidated an interest escalation clause in a mortgage given a federal savings and loan association but only because the lower court's determination was not made pursuant to federal law. Nevertheless, the two cases together demonstrate the court's adherence to the principal that mortgage escalation clauses are valid under certain circumstances.

In *Wauwatosa Colony,* the defendant, who was engaged in the real estate business, executed a mortgage note to the plaintiff in July 1962. One portion of this note provided:

> The rate of interests stipulated herein may be increased at the option of the Association; provided, however, that the Association may not exercise such right in less than 3 years from the date of the loan, and then only upon at least four month's written notice to the borrower; and provided that in the event of such an increase in the stipulated rate of interest the borrower may prepay the loan within such notice period without penalty.[33]

Thereafter, the Association increased the rate of interest on the note by two percent in June 1968, and by an additional one

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Thus, the court appears to support a practical definition of the term "condition precedent" and not a strict theoretical application. But however practical this approach may be, the person relying upon the fulfillment of the conditions precedent to his obligation to perform should be assured beforehand that they will have been satisfied by the time this simultaneous transaction is completed. Moreover, simultaneous should be construed to mean a short period of time.

31. 71 Wis. 2d 174, 237 N.W.2d 729 (1976).

32. 72 Wis. 2d 132, 240 N.W.2d 367 (1976).

33. 71 Wis. 2d at 176, 237 N.W.2d at 730.

percent in May 1970.[34] On February 10, 1971, the defendant had an unpaid principal balance of $40,605.55. On February 19, the plaintiff advanced additional funds to the defendant to pay real estate taxes. When, on February 24, the defendant attempted to pay the balance outstanding on the principal as computed two weeks earlier with a check bearing the notation "mortgage principal balance in full," the plaintiff returned the check. The defendant was informed that the Association refused to accept the check because the real estate tax advance had been added to the outstanding mortgage principal, and for this reason the amount of the check was insufficient to cover the increased balance. Thereafter, the defendant paid to the Association the amount advanced for taxes and again presented the check. The check was again refused.

The primary issue arising from these facts was whether the plaintiff was prohibited by the terms of the mortgage note from increasing its interest rate more than once. The court on appeal was divided with regard to this issue, the disagreement centering on the validity of the plaintiff's argument that the language of the mortgage clause was to be read together with section 215.21(3)(b) of the Wisconsin Statutes.[35] The majority agreed with the Association and, pointing to the fact that the language of the note and the statute was essentially similar, held: "It is manifestly clear that by including the escalator clause in the mortgage contract, the parties were doing so pursuant to the statute."[36] Furthermore, the majority concluded that by including the escalator clause, the parties desired the intendment of the statute to control the note. The note, then, was to be given all of the properties of the statute as interpreted by the court.

The court first determined that the statute was entitled to a liberal construction.[37] It then found that the statute was am-

34. *Id.*

35. WIS. STAT. § 215.21 (3)(b) (1973) provides:

The mortgage or mortgage note may provide that the interest rate may be increased after 3 years from the date hereof, by giving to the borrower at least 4 months' notice of such intention. The borrower may, after the receipt of such notice, repay his loan within the time specified in such notice without payment of any penalty.

36. 71 Wis. 2d at 178, 237 N.W.2d at 731.

37. In this respect, the court acknowledged that statutes in derogation of common law rights to freedom of contract are generally strictly construed. 82 C.J.S. *Statutes* 942, § 393 (1953). However, the court distinguished from this broad class of legislation

biguous,[38] and so looked to its history, context, subject matter and object intended to be remedied or accomplished in order to ascertain the intent of the legislature.[39] Because the statute did not prohibit a multiple utilization of an escalator clause but merely provided the procedural mechanism by which it could be used, the court reasoned that the statute was intended to "cope with . . . changing economic conditions"[40] to prevent long-term notes from unprofitably constricting the availability of investment funds. If intended to permit adjustment of the mortgage note interest rate to current market conditions, more than one use of the escalation provision was logically necessary:

> If the clause were limited in use to a single occasion, the association would necessarily be forced to make the single increase as large as possible, since it could not foresee what might happen in terms of economic conditions during the intervening years between the increase and the end of the mortgage term.[41]

Therefore, while the court deferred to the legislature to determine if the statute should restrict the amounts by which the interest rates could be increased, it nevertheless concluded that the statute did not limit the frequency of such escalations. Consequently, the mortgage note itself permitted multiple increases.[42]

While the majority predicated its decision on the premise that because the contract mimicked the language of the statute, the interpretation of the contract was subordinate to the construction of the statute, the dissent rejected this premise altogether.[43] Rather, it viewed the statute as merely a regula-

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those statutes which establish comprehensive regulatory systems, holding that the latter are entitled to liberal construction. *See* Heiden v. City of Milwaukee, 226 Wis. 92, 100-01, 275 N.W. 922 (1937); Schumacker v. City of Milwaukee, 209 Wis. 43, 46, 243 N.W. 756 (1932); and SUTHERLAND, STATUTORY CONSTRUCTION, § 61.03 at 51-52 (4th ed. 1974).

38. Ambiguity is an essential requisite to statutory interpretation. Amidzich v. Charter Oak Fire Ins. Co., 44 Wis. 2d 45, 51, 170 N.W.2d 813, 816 (1969). A statute is ambiguous when "it is capable of being understood by reasonably well informed persons in either of two or more senses." Madison Metropolitan Sewerage Dist. v. D.N.R., 63 Wis. 2d 175, 199, 216 N.W.2d 533, 535 (1974).

39. 71 Wis. 2d at 180, 237 N.W.2d at 732, citing Ortman v. Jensen & Johnson, Inc., 66 Wis. 2d 508, 225 N.W.2d 635 (1975).

40. 71 Wis. 2d at 180, 237 N.W.2d at 732.

41. *Id.* at 181-82, 237 N.W.2d at 733.

42. *Id.* at 183, 237 N.W.2d at 734.

43. Chief Justice Wilkie and Justice Beilfuss joined in a dissent authored by Justice

tory provision enabling the parties to a mortgage contract to "provide that the interest rate may be increased."[44] According to the dissent, the statute did not make interest rates in all mortgage contracts subject to escalation, but merely permitted the parties in their bargaining process to so provide.[45] Therefore, as a provision of a contract included as a result of the bargaining process of the parties, any questions relating to its ambiquity and subsequent construction should be based on established principles of contract law. If the provision is found to be ambiguous, then it should be construed against its writer.

The effect of the court's decision in *Wauwatosa Colony* has been modified by two subsequent events. First, the lack of unanimity of the court has been ameliorated in part by the case of *Kaski v. First Federal Savings & Loan Association,*[46] in which the court again faced the question of the validity of a mortgage interest rate escalation clause. This provision, however, was distinguished from that in *Wauwatosa Colony* by the fact that its validity should not be governed by section 215.21(3)(b) of the Wisconsin Statutes, but instead should be controlled by corresponding federal legislation. Because the trial court found the clause valid under the state statute, the court reversed, giving the plaintiffs the option to request a new trial to test the validity of the clause in light of the more appropriate legislation.

But in doing so, the court took the opportunity to state with unanimity its view of section 215.21(3)(b): "*Security Savings & Loan Asso.* . . . validated escalation clauses in respect to Wisconsin savings and loan associations and held that even a second escalation may be permitted under a properly drafted agreement between the parties."[47] The precise significance of this statement is difficult to assess. On the one hand, there appears to be a shift in the opinion of the *Wauwatosa Colony* majority from emphasizing the domination of the statute over

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Heffernan. Justice Robert Hansen concurred in part, and dissented in part.

44. 71 Wis. 2d at 192, 237 N.W.2d at 738.

45. Throughout this dissent, emphasis was placed upon the duty of the parties to bargain for such a provision, and the duty of the scrivener of the contract to unambiguously provide its terms. Moreover, the justices joining in this dissent apparently took notice of a practice not uncommon in such financing situations: omitting an interest escalation clause in turn for a higher initial interest rate. *Id.* at 192, 237 N.W.2d at 738.

46. 72 Wis. 2d 132, 240 N.W.2d 367 (1976).

47. *Id.* at 134, 240 N.W.2d at 369-70.

the contract to emphasizing the requirement of a properly drafted agreement. On the other hand, the *Wauwatosa Colony* dissenting justices seem to now be subscribing to an interpretation of the statute permitting multiple increases.

Second, new legislation repealing section 215.21(3)(b), and creating a new section 138.053[48] has modified the *Wauwatosa*

48. 1975 Wis. Laws, ch. 387, § 1, creating section 138.053 of the statutes to read:

138.053 Regulation of interest adjustment provisions

(1) Required contract provisions. No contract between a borrower and a lender secured by a first lien real estate mortgage on, or an equivalent security interest in, an owner-occupied residential property containing not more than 4 dwelling units may authorize the lender to increase the borrower's contractual rate of interest unless the contract provides that:

(a) No increase may occur until 3 years after the date of the contract;

(b) No increase may occur unless the borrower is given at least 4 months' written notice of the lender's intent to increase the rate of interest, during which notice period the borrower may repay his or her obligation without penalty;

(c) The amount of the initial interest rate increase may not exceed $1 per $100 for one year computed upon the declining principal balance;

(d) The amount of any subsequent interest rate increase may not exceed $1 per $200 for one year computed upon the declining principal balance;

(e) The interest rate may not be increased more than one time in any 12-month period; and

(f) The loan may be prepaid without penalty at any time at which the interest rate in effect exceeds the originally stated interest rate by more than $2 per $100 for one year computed upon the declining principal balance.

(2) Disclosures required. No lender may make a loan secured by a first lien real estate mortgage on, or an equivalent security interest in, an owner-occupied residential property containing not more than 4 dwelling units providing for prospective changes in the rate of interest unless it has clearly and conspicuously disclosed to the borrower in writing:

(a) That the interest rate is prospectively subject to change;

(b) That notice of any interest adjustment must be given 4 months prior to any increase; and

(c) Any prepayment rights of the borrower upon receiving notice of such change.

(3) Notice of interest adjustment. Notices provided under sub. (2) shall be mailed to the borrower at his or her last-known post-office address and shall clearly and concisely disclose:

(a) The effective date of the interest rate increase;

(b) The increased interest rate and the extent to which the increased rate will exceed the interest rate in effect immediately before the increase;

(c) The amount of the borrower's contractual monthly principal and interest payment before and after the effective date of the increase;

(d) Any right of the borrower to voluntarily increase his or her contractual principal and interest payment;

(e) Whether as a result of the increase a lump sum payment may be necessary at the end of the loan term;

(f) Whether an additional number of monthly payments may be required; and

(g) The borrower's right to prepay within 4 months without a charge.

Colony decision with regard to those situations arising after June 12, 1976. The new statute includes a number of provisions which were contained in the former. It prohibits mortgage interest rate escalation within three years of the contract's execution, requires four month's written notice to be given the debtor, and allows the debtor to satisfy the obligation within this time without penalty.

The new statute, however, departs from the former in a number of important ways, and clarifies the questions left unanswered by these cases. First, it provides that the amount of the initial increase may not exceed one percent per year computed on the declining principal balance. Moreover, the new legislation provides that no subsequent rate increase may exceed one half of one percent computed on the declining principal balance and that subsequent increases shall not be more frequent than once every twelve months. The debtor is thereby initially assured that no increase will occur during the first three years of the indebtedness and that thereafter the rate will only increase by one percent the first year, and one half percent each following year.

Second, the new legislation further protects the debtor by permitting prepayment of the indebtedness without penalty whenever the interest rate exceeds the original by two percent. Thus, if a lender increases the interest rate of the mortgage by these statutory maximums, any additional increase will permit the debtor to repay the loan without penalty five years after the contract's inception.

Third, and perhaps most important with respect to the *Wauwatosa Colony* decision, the new statute requires full disclosure by the lender, informing the borrower of the fact that the rate may be increased, the notice to which is is entitled, and his right to prepayment without penalty. Perhaps through this disclosure, questions as to whether the parties intended the provision to be a part of the mortgage contract may be avoided.

Even though the statute makes great strides in clarifying the conditions under which a mortgage escalator clause may be utilized, its applicability is nevertheless limited. It is first lim-

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(4) **Applicability.** (a) This section does not apply to variable rate contracts, nor to loans or forbearances to corporations.

(b) This section applies only to transactions initially entered into on or after the effective date of this act (1975).

ited to interest escalation clauses. It is limited, also, to transactions initially entered into on or after the effective date of the act, June 12, 1976. Most significantly, it is limited to first lien real estate mortgages on or security interests in owner-occupied residential property comprising not more than four dwelling units. Finally, the statute is inapplicable to loans or forbearances made to corporations.

Because of these limitations, the validity of certain escalation provisions may still be in question. For example, because the new statute is inapplicable to loans made to corporations, the defendant in *Wauwatosa Colony* would not have been able to rely on the new legislation. But because the Act repealed section 215.21(3)(b), on which the escalation provision in *Wauwatosa Colony* was obviously based, some question still exists as to whether any mortgage rate escalation clause, except one which meets the requisites of the new statute, may be utilized at all. Therefore, much remains to be clarified in this area of the law.

C. *Changed-Conditions Clauses*

In *Metropolitan Sewerage Commission v. R. W. Construction*,[49] the court held that a contractor was entitled to an equitable adjustment of the contract price under a changed-conditions clause when actual conditions encountered materially differed from those indicated in the project specifications and drawings. This provision was contained in a contract for the construction of a subterranean sewerage system executed by the Metropolitan Sewerage Commission of Milwaukee and R. W. Construction, the contractor, and provided that in the event that a latent condition was encountered which materially differed from those indicated in the specifications and drawings, the time allowed for completion and the cost of the project could be adjusted.[50]

The contract itself was a composite of various specifications, drawings and agreements. Before contract bids were sought, the Commission had sixteen boring tests performed along the route of the project. From these test results, or logs, a consulting firm prepared contract drawings to indicate the area's subterranean composition, particularly the presence or

49. 72 Wis. 2d 365, 241 N.W.2d 371 (1976).
50. *Id.* at 368-69, 241 N.W.2d at 374-75.

absence of artesian water.[51] Bidding instructions given to the prospective bidders indicated that the actual test logs would be available for inspection, but the contract specifications, also a part of the bidding documents, included an assurance that the result and locations of the borings were shown in the drawings.[52] Finally, the contract itself contained provisions for equitable adjustment of the terms of the contract in the event that the actual conditions encountered materially deviated from those indicated in the drawings and specifications.[53]

Almost immediately after the contractor began work in August 1969, artesian water was discovered. Normal measures to control the problem failed, and upon the suggestion of a consultant to the contractor, the route of the project was modified under the changed-conditions clause. However, further progress resulted in further artesian water discoveries, requiring additional measures to be taken. Finally, in February 1971, all work halted when carbon dioxide gas, generated in part by measures used to control the flooding, escaped the tunnel and permeated the surrounding residential neighborhood. The local health commissioner ordered both the Commission and the contractor to abate the hazard, resulting in a complete halt to the work. When the contractor again attempted to invoke the changed-conditions provision, the Commission refused and notified the contractor that unless work was resumed within ten days, the contract would be terminated. The contractor refused to recommence work without relief, and the contract was terminated by the Commission. The Commission then brought this action to recover damages, and was awarded judgment.

In the opinion of the court, one issue was controlling on appeal: "Did [the contractor] encounter an artesian water condition which materially differed from the conditions shown in the drawings and indicated in the specifications, so that it was entitled to receive an equitable adjustment in the contract price?"[54] In formulating this issue, the court catagorized

51. *Id.* at 366-67, 241 N.W.2d at 374. The importance of the presence of artesian water, as distinguished from static water, is the difficulty it presents in subterranean excavaction efforts. Artesian water is under pressure, and requires complicated and time-consuming measures to control. Static water, however, is not under pressure and is more easily removed or drawn down.

52. *Id.* at 376, 241 N.W.2d at 378.

53. *Id.* at 368, 241 N.W.2d at 374-75.

54. *Id.* at 371, 241 N.W.2d at 376.

changed-conditions clauses into two groups. The first group consists of clauses which attempt to resolve conflicts where the conditions encountered materially differ from the conditions indicated. The second group includes clauses which cover situations where unknown conditions of an unusual nature were encountered. Finding the changed-conditions clause in the instant contract to be of the first type, the court relied upon federal case law to state: "[T]he applicability of the modern changed-conditions clause depends only upon a comparison of the actually encountered conditions with the indicated conditions, and not upon the fulfillment of equitable or common-law prerequisites to relief."[55] Therefore, the court reasoned, the question of what conditions were shown in the drawings or indicated in the specifications, and the question of whether the conditions actually encountered materially differed from those indicated, were both questions of law and subject to its independent review. A third question, directed to the determination of what conditions were actually encountered, was denominated a question of fact.

However, only the question going to the conditions represented in the contract was discussed.[56] To determine what has been represented in a construction contract of this nature, the court enunciated the rule that although the representations made need not be explicit or specific, the information they contain must positively indicate the existence of conditions other than those actually encountered.[57] Presumably, then, if the specifications give only a neutral indication of the existence of water, the representation will be adequate to indicate the existence of either artesian or static water.[58] When, however, the existence of static water is affirmatively indicated in the specifications, the contract will not be construed as indicating the existence of artesian water. The court determined that the

55. *Id.* at 372-73, 241 N.W.2d at 377.

56. The trial court's determination that artesian water was actually encountered was not disturbed by the court. Moreover, the trial court's legal conclusion that artesian water materially differed from static water was likewise accepted. *Id.* at 373-74, 241 N.W.2d at 377.

57. *Id.* at 374-75, 241 N.W.2d at 377-78.

58. This example is drawn from the case of Flippin Materials Co. v. United States, 312 F.2d 408 (Ct. Cl. 1963), cited by the *R. W. Construction* court, wherein the contractor was not entitled to assume pockets of soil indicated as being present in a limestone layer were composed of sand and not clay.

specifications in this contract clearly and positively indicated static water:

> It is undisputed that the contract drawings of the borings do not state that water rose in the boring after it was encountered in drilling, which is the acceptable method of noting artesian water. The drawings state only that the water level is at a certain depth. This is an affirmative indication of static water, not artesian water.[59]

Although the contract was comprised of numerous documents, the court held that the contractor was entitled to rely upon information obtained by boring tests as it was represented in the contract drawings. Sixteen boring tests were conducted, but only one of the written logs prepared from the data obtained from these tests indicated the existence of artesian rather than ground water. The contract drawings prepared to reflect the locations and results of the tests did not, however, reveal this condition. The court, then, concluded that the contractor had a right to rely on the representation made in the drawings, and was not obligated to search through the written logs to find the single artesian water notation.[60] While a contractor is held to the standard of what a reasonable contractor—relying on his past experience, the customs and insights shared generally by contractors in the area, and the information conveyed by the contract—would have anticipated under similar conditions,[61] the court nevertheless concluded that these factors did not impeach the reasonableness of the contractor's reliance on the contract drawings.[62]

Further, the court held that the Commission is deemed to have warranted the adequacy of its plans and specifications as indications of the complexity and nature of the undertaking.[63] The result, then, seems to be that when inconsistencies appear on the face of the various components of a construction con-

59. 72 Wis. 2d at 375, 241 N.W.2d at 378 (footnote omitted).

60. In this respect, the court pointed to a provision in the contract specifications which provided:

> The Metropolitan Sewerage Commission of the County of Milwaukee has made test borings along the route of that portion of the sewer in this contract. The logs and locations of these borings are shown on the drawings . . . .

The court concluded that this was a specific and express indication that the contract drawings accurately represented the boring test results. *Id.* at 376, 371 N.W.2d at 378.

61. *Id.* at 377-78, 371 N.W.2d at 379.

62. *Id.* at 378-79, 371 N.W.2d at 379-80.

63. *Id.* at 379, 371 N.W.2d at 380.

tract of this nature, the contractor is entitled to rely on the one portion which synopsizes the vast information found in the entirety. This is true, apparently, even though the contractor knows of the existence of documents containing further data and is requested to consult them.[64]

Finally, the court held that this contractor's deficiencies with regard to pre-bid planning and post-award performance had no bearing on the contractor's right to an equitable adjustment under the changed-conditions provision.[65] Rather, these were factors to be considered in determining the amount of adjustment to which the contractor was entitled after it had initially been determined that an adjustment was warranted. If the contractor had increased costs due to his inefficiency in planning and performance, he must absorb them. Therefore, the amount of equitable adjustment to which a contractor is entitled is "the difference between what it reasonably cost to do the work under the actually encountered conditions and what it would have cost if the materially different conditions had not been encountered."[66] The contractor's right to an equitable adjustment is not jeopardized by his inefficiencies, but the amount of his recovery is.

This decision is important insofar as it attempts to summarize the duties and obligations of the parties to a government project contract. The necessity of consistency between the various components of such a contract is made clear by the fact that the court has allowed the contractor to rely upon one of those components. Contract indications which affirmatively represent only one of two possible, though similar, conditions will be the controlling factor in determining the materiality of differences actually encountered. Finally, the inadequacies of the contractor's planning and performance will at most lessen the amount of his equitable adjustment. This last conclusion, however, is a difficult one to reach. While the contractor is held to the standard of what a reasonable contractor, with similar experience and information, would expect in determining the reasonableness of his interpretation of and reliance on the contract specifications, and therefore his right to an equitable ad-

64. *Id.* at 376-78, 371 N.W.2d at 378-79.
65. *Id.* at 383, 371 N.W.2d at 381-82.
66. *Id.* at 384, 371 N.W.2d at 382.

justment,[67] the adequacy of his preparation and performance merely reduces the amount of the adjustment. The court should make a clearer distinction between these tests, for the same instances of action or nonaction, reasonableness or unreasonableness, might apply to either test.

D. Covenants Not to Compete

In *Behnke v. Hertz Corp.*,[68] the court held that the restrictions imposed by a covenant not to compete must be reasonably necessary for the protection of the employer to be valid and enforceable. The protection afforded the employer was limited by the court to the unique characteristics of the employment, the trade secrets and customer lists of the employer, and the geographical scope of its business.

The convenant not to compete under consideration in this case was contained in a contract between National Car Rental System and one of its employees who processed lease agreements with its customers.[69] The employee did not utilize any customer lists nor did she know any of National's trade secrets. The employee was assigned to National's Milwaukee airport counter, its only place of business in the area. After approximately six months, the employee terminated her employment with National and took a similar position with the Hertz Corporation. She was assigned to the latter's railroad depot location.

The plaintiff, who owned the National franchise, brought suit against Hertz for inducing the employee's breach of the covenant. The trial court found for the plaintiff and awarded both compensatory and punitive damages. On appeal, the Wisconsin Supreme Court found the covenant invalid as a matter of law, and remanded the case for dismissal.[70]

In Wisconsin, covenants not to compete are controlled by section 103.465 of the Wisconsin Statutes, requiring that such covenants be reasonable in their scope and reasonably necessary to protect the interests of the employer.[71] Because such

67. *Id.* at 377-78, 371 N.W.2d at 379. *See* text accompanying note 61 *supra.*

68. 70 Wis. 2d 818, 235 N.W.2d 690 (1975).

69. The covenant signed by the employee stated: "I agree not to work for any car rental competitor in the City of Milwaukee for one year if and when this present job is terminated." *Id.* at 820, 235 N.W.2d at 692.

70. *Id.* at 819-20, 235 N.W.2d at 691-92.

71. WIS. STAT. § 103.465 (1973) provides:

covenants are generally looked upon with disfavor,[72] the court gave two factors to be considered in evaluating a covenant's reasonableness: (a) whether enforcement of its terms would be necessary to prevent the use of the employer's trade secrets or customer lists, and (b) whether the services of the employee are unique.[73] If neither condition exists, the fact that the employee will exercise, in the absence of enforcement, skills and knowledge acquired during his employment is not sufficient to allow the covenant's enforcement.[74] The court found that the services of this particular employee were not unique, and that she had no knowledge of trade secrets or lists.

The court further indicated that even if the covenant were enforceable because of the nature of the employment, it was nevertheless unenforceable because of geographical limitations. Covenants not to compete are limited geographically by the territorial extent of the employer's business, and this geographical scope may not be broadened contractually.[75] Here, because the actual business of the employer was limited to the Milwaukee airport, the covenant, in spite of its attempt to encompass all of the greater Milwaukee area, would have been enforceable only within the airport area.[76]

III. DEFENSES

A. *Defenses to Claims of Materials Suppliers*

In *Schneider Fuel & Supply Co. v. West Allis State Bank*,[77]

A covenant by an assistant, servant or agent not to compete with his employer or principal during the term of the employment or agency, or thereafter, within a specified territory and during a specified time is lawful and enforceable only if the restrictions imposed are reasonably necessary for the protection of the employer or principal. Any such restrictive covenant imposing an unreasonable restraint is illegal, void and unenforceable even as to so much of the covenant or performance as would be a reasonable restraint.

72. 70 Wis. 2d at 821, 235 N.W.2d at 692. *See* RESTATEMENT (SECOND) OF CONTRACTS § 513 (1973).

73. *Id.* at 822, 235 N.W.2d at 693. The court cited RESTATEMENT (SECOND) OF CONTRACTS, § 516(f), Comment h at 996 (1973), which states:

A promise of a former employee will not ordinarily be enforced so as to preclude him from exercising skill and knowledge acquired in his employer's business, even if the competition is injurious to the latter, except so far as to prevent the use of trade secrets or lists of customers, or unless the services of the employee are of a unique character.

74. *Id.* at 822-23, 235 N.W.2d at 693.

75. Wisconsin Ice & Coal Co. v. Lueth, 213 Wis. 42, 250 N.W. 819 (1933).

76. 70 Wis. 2d at 823, 235 N.W.2d at 694.

77. 70 Wis. 2d 1041, 236 N.W.2d 266 (1975).

the court expanded the scope of section 289.16 of the Wisconsin Statutes to hold that funds received by a bank from a contractor engaged in public improvement contracts are held in trust by the bank and subject to the claims of the contractor's suppliers.

This case arose out of business arrangements between the contractor and the plaintiff-supplier and financing arrangements between the contractor and the bank. The plaintiff supplied the contractor with various materials under an open credit arrangement. Money received from the contractor was applied to the oldest of its accounts. On September 16, 1976, the contractor owed the plaintiff $318,912 for materials supplied before the contractor entered into a contract with a municipal corporation for the purpose of building sewers. All materials supplied to the contractor for use in the municipal project were supplied after September 6. After this date, the contractor paid a total of $250,000 to the plaintiff. Because these payments were credited to the earlier accounts, none of the materials supplied for the municipal project were paid, leaving at the time the contractor ceased doing business an outstanding balance of $397,366.18.

Under the arrangement between the contractor and the bank, the contractor submitted an assignment form and an invoice addressed to its customer in exchange for a loan of seventy percent of the invoice amount. The assignment of the account was taken by the bank as collateral. The total outstanding debt, however, was limited to $75,000. When the contractor was paid by its customer, it deposited the funds in its personal account with the bank, from which it would draw a check payable to the bank.

The supplier brought this action against the bank for the value of the materials supplied to the contractor for the municipal project, contending that funds received by the contractor were held in trust by the bank for the satisfaction of its claim. Judgment was awarded to the plaintiff and the bank appealed, raising five issues.

The first issue raised by the bank was whether the supplier was a claimant under section 289.16 of the Wisconsin Statutes.[78] The bank contended that the supplier was not a claim-

78. WIS. STAT. § 289.16 (1973) provides:
Theft by contractors. All moneys, bonds or warrants paid or to become due,

ant under the statute because it did not make immediate demands for payment of each individual supply contract with the contractor, and because its open account arrangement with the contractor negated any knowledge on the part of the bank and the contractor that the supplier was demanding payment from the contract proceeds. Further, the defendant argued that the trust imposed by section 289.16 was not created until a claim was made by a materials supplier.

The court summarily rejected these arguments on two grounds. First, the court cited *Weather-Tite Co. v. Lepper*[79] for the rule that the statute makes no material distinction between a claimamt and a creditor. While the bank inferred from the term "claimant" some affirmative action on the part of a creditor to collect an account, the court concluded that such efforts were unnecessary to invoke the statute and required only that the creditor have supplied "materials used for such improvements."[80] Second, the court rejected the arguments because they were raised for the first time on appeal.[81]

The second issue raised by the bank was whether it could be considered to be a trustee of the funds for the purposes of section 289.16. The bank contended that the constructive trust imposed on the funds by the statute existed "only when and while they are in the hands of the contractor"[82] and not upon a portion of those funds paid by the contractor to the bank. The bank further contended that its duty as a depository bank of trust funds was governed by section 112.01(10).[83] This section

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to any prime contractor or subcontractor for public improvements are a trust fund in his hands: and the use of the moneys by him for any purpose other than the payment of claims on such public improvement, before the claims have been satisfied, constitutes theft and is punishable under s. 943.20. Until all claims are paid in full, have matured by notice and filing or have expired, such money, bonds and warrants shall not be subject to garnishment, execution, levy or attachment.

79. 25 Wis. 2d 70, 130 N.W.2d 198 (1964) (construing WIS. STAT. § 289.02(4) (1963) which imposed a constructive trust upon proceeds paid to a contractor for work done on private improvements.)

80. 70 Wis. 2d at 1047, 236 N.W.2d at 269.

81. *Id.*

82. *Id.* at 1048, 236 N.W.2d at 269.

83. WIS. STAT. § 112.01(10) (1973) provides:

DEPOSIT IN FIDUCIARY'S PERSONAL ACCOUNT. If a fiduciary makes a deposit in a bank to his personal credit of checks drawn by him upon an account in his own name as fiduciary, or of checks payable to him as fiduciary, or of checks drawn by him upon an account in the name of his principal if he is empowered to draw checks thereon, or of checks payable to his principal and indorsed by him, if he

requires actual knowledge of a breach of trust by a fiduciary in making withdrawals from such funds to impose liability on a depository bank.

The bank, however, was not merely the depository bank of the funds but also the payee of the funds withdrawn, and the court relied upon this in refusing to limit the bank's responsibility to that declared in section 112.01(10) and in distinguishing the cases proffered by the bank which required actual knowledge.[84] While citing section 112.01(8)[85] for the proposition that when a payee, rather than a drawee, bank is involved, additional responsibilities are imposed with regard to the use of trust funds, the court relied primarily upon the Commissioner's Notes to the Uniform Fiduciaries Act: "[W]here the fiduciary makes a deposit in his personal account and subsequently pays a personal debt to the bank by a check on that account, the bank must ascertain what is done with the funds withdrawn."[86] The court reasoned that because the bank knew the origin of the funds received by the contractor, because it was a payee as well as drawee of the funds transferred, and because of the responsibilities deriving from the trust imposed by section 289.16, the bank was a trustee of those funds received from the contractor for the purposes of the statute.

This, perhaps, is the most significant, although confusing, aspect of the decision. However, the legislature has since nullified its consequences for those situations arising on or after June 11, 1976, by amending both sections 112.01(10)[87] and

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is empowered to indorse such checks, or if he otherwise makes a deposit of funds held by him as fiduciary, the bank receiving such deposit is not bound to inquire whether the fiduciary is committing thereby a breach of his obligation as fiduciary; and the bank is authorized to pay the amount of the deposit or any part thereof upon the personal check of the fiduciary without being liable to the principal, unless the bank receives the deposit or pays the check with actual knowledge that the fiduciary is committing a breach of his obligation as fiduciary in making such deposit or in drawing such check, or with knowledge of such facts that its action in receiving the deposit or paying the check amounts to bad faith.

84. London & Lancashire Indem. Co. v. American State Bank, 244 Wis. 203, 12 N.W.2d 133 (1943); Murphy v. National Paving Co., 229 Wis. 100, 281 N.W. 705 (1938).

85. WIS. STAT. § 112.01(8) (1973).

86. 7 UNIFORM LAWS ANNOT., *Uniform Fiduciaries Act* § 9, Commissioner's Notes at 414-15 (West 1970).

87. 1975 Wis. Laws, ch. 409, § 1, amending WIS. STAT. § 112.01(10) (1976) to read:

Deposit in fiduciary's personal account. If a fiduciary makes a deposit in a bank to . . . *the fiduciary's* personal credit of checks drawn by . . . *the fiduciary* upon an account in his *or her* own name as fiduciary, or of checks

289.16.[88] The new legislation effectively reverses the court's decision by imposing a trust on funds received by a contractor for public improvements only so long as they are held by the contractor. Checks drawn on the contractor's personal account made payable to a drawee bank for the satisfaction of a personal obligation will no longer impose liability on that bank in the absence of knowledge of a breach of trust or bad faith. In such a case the civil cause of action is limited to an action against the contractor.[89]

The bank also raised a third issue of whether it was a holder in due course of the check received from the contractor.[90] As a holder in due course, the bank hoped to claim the defenses afforded by section 403.305 of the Wisconsin Statutes. However, the court rejected this argument on two grounds. First, it interpreted section 403.302 as requiring the claimant to the status of holder in due course to have actual possession of the

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payable to . . . *the fiduciary* as fiduciary, or of checks drawn by . . . *the fiduciary* upon an account in the name of his *or her* principal if . . . *the fiduciary* is empowered to draw checks thereon, or of checks payable to his *or her* principal and indorsed by . . . *the fiduciary*, if . . . *the fiduciary* is empowered to indorse such checks, or if . . . *the fiduciary* otherwise makes a deposit of funds held by . . . the fiduciary as fiduciary, the bank receiving such deposit is not bound to inquire whether the fiduciary is committing thereby a breach of his *or her* obligation as fiduciary. . . . *The* bank is authorized to pay the amount of the deposit or any part thereof upon the personal check of the fiduciary, *including checks payable to the bank,* without being liable to the principal, unless the bank receives the deposit or pays the check with actual knowledge that the fiduciary is committing a breach of his *or her* obligation as fiduciary in making such deposit or in drawing such check, or with knowledge of such facts that its action in receiving the deposit or paying the check amounts to bad faith, *and the bank paying the check is not bound to inquire whether the fiduciary is committing thereby a breach of his or her obligation as fiduciary.*

88. 1975 Wis. Laws, ch. 409, § 3, amending WIS. STAT. § 289.16 (1973) to read:

All moneys, bonds or warrants paid or to become due, to any prime contractor or subcontractor for public improvements are a trust fund *only* in . . . *the* hands . . . *of the prime contractor or subcontractor and shall not be a trust fund in the hands of any other person. The* use of the moneys by . . . *the prime contractor or subcontractor* for any purpose other than the payment of claims on such public improvement, before the claims have been satisfied, constitutes theft *by the prime contractor or subcontractor* and is punishable under s. 943.20. *This section shall not create a civil cause of action against any person other than the prime contractor or subcontractor to whom such moneys are paid or become due.* Until all claims are paid in full, have matured by notice and filing or have expired, such money, bonds and warrants shall not be subject to garnishment, execution, levy or attachment.

89. 1975 Wis. Laws, ch. 409, §§ 1, 3.

90. WIS. STAT. § 403.302 (1973).

instrument.[91] The court found no evidence that the bank had possession of the check:

> We deal here with checks paid from [the contractor's] account and canceled or stamped "Paid" by the bank. There is nothing in this record to negative the usual banking practice of returning canceled checks to the person on whose account they were drawn. No attempt was made at the trial court to suggest or establish that the defendant bank was "in possession" of such canceled checks.[92]

Because the bank failed to prove possession, the court found that it was not entitled to the status of holder in due course. The court also rejected the argument because the bank was chargeable with knowledge that the funds in its possession were subject to a statutory trust and therefore took the funds with notice of a claim to them on the part of another person.[93]

Finally, the court summarily rejected the bank's contention that it was entitled to the defenses of laches and equitable estoppel. The court held that the bank had not been prejudiced by the supplier's failure to promptly make its claim against the bank, and that there was no duty on the part of the plaintiff to inform the bank of defaults in payment by the contractor.[94]

B. Accord and Satisfaction

In *Chicago & North Western Transportation Co. v. Thoreson Food Products*,[95] the court determined that the Interstate Commerce Act precluded the use of accord and satisfaction as a defense to a suit brought by an interstate carrier for shipping charges.

The plaintiff, a foreign railroad corporation subject to the Interstate Commerce Act, made two shipments of canned goods to the defendant. The transportation costs of the first shipment were prepaid by the defendant, but when it was discovered that some of the goods had been spoiled in transit, the defendant initially refused to accept them. The defendant then agreed to salvage as much of the goods as possible following

91. The term "holder" is defined as a person who is "in possession of a document of title or an instrument or an investment security drawn, issued or indorsed to him or to his order or to bearer or in blank." WIS. STAT. § 401.201(20) (1973).

92. 70 Wis. 2d at 1051-52, 236 N.W.2d at 271.

93. WIS. STAT. § 403.302(1)(c) (1973).

94. 70 Wis. 2d at 1053-55, 236 N.W.2d at 272-73.

95. 71 Wis. 2d 143, 238 N.W.2d 69 (1976).

discussions with the plaintiff's claims representative. When the defendant later submitted its claim for the lost goods to the plaintiff, the plaintiff denied it.

Meanwhile, the plaintiff transported the second load of goods to the defendant. The charges for this shipment were not prepaid, and amounted to $1758.96. The defendant's informal complaint to the Interstate Commerce Commission for the losses to the first shipment was denied,[96] and consequently the defendant sent payment in the amount of $167.33 to the plaintiff. This check was accompanied by a letter which stated that its amount represented the difference between the freight charges for the second shipment and the damages claimed for the losses to the first shipment.[97] The plaintiff cashed the check.

The trial court, on motions for summary judgment, held that the defendant had a complete defense to the plaintiff's claim for the freight charges on the second shipment. The supreme court disagreed, concluding that while all of the elements of accord and satisfaction may have been present,[98] the applicability of the Act required the defense to be pleaded as a counterclaim and proved as such.[99] The purpose of the Act, the court stated, was to avoid preferential treatment of some shippers to others.[100] Therefore only judicially supervised setoffs would be permissible under the Act; privately arranged settlements and the assertion of accord and satisfaction would not.[101]

The court also rejected the defendant's contention that the plaintiff was estopped from asserting the Act's two years and

96. *Id.* at 145-46, 238 N.W.2d at 71. The Commission denied the claim on the grounds that it lacked jurisdiction, and advised the defendant to furnish additional evidence to the plaintiff or to bring a court action.

97. *Id.* at 146, 238 N.W.2d at 71. The check itself bore the notation, "[i]n settlement of the above account."

98. Of the elements to the defense of accord and satisfaction, the court stated:

> As a generalization, it is the law of this state that when a party accepts, without objection, a check which he knows to be offered in full settlement of a disputed account, he is estopped from claiming in the future that the account has not been settled. The acceptance of the check constitutes a good accord and satisfaction.

Id. at 146, 238 N.W.2d at 71.

99. *Id.* at 149-50, 238 N.W.2d at 73.

100. Interstate Commerce Act, 49 U.S.C. § 6(7) (1970).

101. 71 Wis. 2d at 148-49, 238 N.W.2d at 72.

one day statute of limitations against its damage claim.[102] The court reasoned that even though certain representations had been made by the plaintiff's claims representative, the defendant's reliance on those representations was not reasonable in view of the Commission's previous rejection of its claim.

C. *Defenses of Surety Bondsmen*

In *Riley Construction Co. v. Schillmoeller & Krofl Co.*,[103] the court held that in an action against a surety, the terms of the principal contract and of the bond are to be read together, and that any contract defense available to the principal is also available to the bondsman.

Three subcontractors entered into similar contracts with a general contractor for the construction of condominium apartments. Each contract called for a monthly payment to the subcontractors of a proportion of the value of the work accomplished the previous month, with a final payment at the completion of the work. In addition, the contracts provided that these payments were to be made after the equivalent payment had been received from the owner by the contractor.[104]

The contractor obtained a payment bond from the defendant surety. While the bond assured the payments due the subcontractors in terms similar to those of the subcontracts, it failed to include the proviso of withholding payment until money had been received from the owner.[105]

The subcontractors completed their work satisfactorily, but the owner failed to make final payment to the general contractor. The general contractor, therefore, made no final payments to the subcontractors. The subcontractors brought separate actions against the general contractor and the surety, the actions were consolidated for trial, and judgment was granted to the plaintiffs.

The surety contended at trial and on appeal that it was not liable to the subcontractors on the bond because the general contractor was not liable to them on the contract. But the trial court refused to look beyond the terms of the bond and denied the surety the right to assert the contract defense. The supreme court reversed for two reasons.

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102. Interstate Commerce Act, 49 U.S.C. § 20(11) (1970).
103. 70 Wis. 2d 900, 236 N.W.2d 195 (1975).
104. *Id.* at 902-03, 236 N.W.2d at 196.
105. *Id.* at 903, 236 N.W.2d at 197.

First, looking to the law of suretyship in other jurisdictions, the court held that not only is the surety's liability to the claimant measured by the liability of the principal, but also that the surety may normally set up any defense to the claim available to the principal.[106] Moreover, the bond and the contract it assures must be read together to determine liability.[107]

Second, the court found error in the construction given the language of the bond itself. The trial court had interpreted the terms of payment stated in the bond as automatically resulting in the surety's liability for full payment. The supreme court, however, held that the bond merely conferred upon the subcontractors the right to bring an action against the general contractor, the surety, or both.[108] Once an action was brought, the subcontractors were required to prove their case. The trial court should have thereupon construe the terms of both the contracts and the bonds. Only after the contractor was found to have breached the contract would the surety be liable.[109]

D. Unjust Enrichment

In *Seegers v. Sprauge,*[110] the court held that an action brought by a subcontractor to recover the value of materials and services rendered to a landowner in constructing certain improvements, though denominated an action in quantum meruit, nevertheless required a showing that the landowner had been enriched under circumstances which were unjust.

The defendant owned two lots upon which he was building houses. He arranged with a contractor for the installation of plumbing and septic systems. The contractor in turn requested the plaintiffs to install the septic systems. Before the work began, the plaintiff inspected the sites, met the defendant, and informed him that larger systems than those planned would be necessary and that the plaintiff would be installing them. The defendant agreed to the larger systems, and also requested that the plaintiff remove any excess earth to a particular area.

When the work was completed, the plaintiffs sent their bills

106. *Id.* at 905, 236 N.W.2d at 198.

107. *Id.*

108. *Id.* at 906, 236 N.W.2d at 198.

109. *Id.*, 236 N.W.2d at 198-99. Because the trial court had not considered the effect of the contract language upon the right of the subcontractors to payment, the court ruled that summary judgment was inappropriate.

110. 70 Wis. 2d 997, 236 N.W.2d 227 (1975).

to the contractor who was to present them to the owner for payment. When the plaintiffs did not receive payment, they encumbered the properties. The contractor, meanwhile, absconded. The plaintiffs, therefore, brought this action against the landowner after their efforts to enforce their mechanic's lien failed.[111]

The plaintiffs, denominating their action as one in quantum meruit, prevailed at trial on the basis that services were performed at the instance of the defendant with the expectation of reasonable compensation.[112] The trial court, however, did not address the question of whether the defendant was unjustly enriched in retaining the benefit of those services. The supreme court concluded that the principle of unjust enrichment is a common theme to all quasi-contract actions, imposing similar elements:

> (1) a benefit conferred upon the defendant by the plaintiff, (2) appreciation by the defendant of the fact of such benefit, and (3) acceptance and retention by the defendant of the benefit, under circumstances such that it would be inequitable to retain the benefit without payment of the value thereof.[113]

Therefore, the person conferring the benefit on the other may not avoid the requirement of showing that the recipient was unjustly enriched by denominating his action as quantum meruit. The testimony of the defendant that payment for the services rendered by the plaintiffs was made to the contractor was consequently relevant to this issue.

Finally, the court held that the contacts between the parties were insufficient to negate the plaintiffs' status as subcontractors and to permit the finding of an implied agreement. The plaintiffs, as subcontractors, were requested to perform the primary service of installing the systems by the contractor, and not at the special instance of the landowner.[114] Recovery under quantum meruit, unlike unjust enrichment, would require facts sufficient to support a finding that the services were performed upon the request of the landowner.

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111. *Id.* at 998-1000, 236 N.W.2d at 228.

112. *Id.* at 1002, 236 N.W.2d at 229. *See also* Estate of Voss, 20 Wis. 2d 238, 241, 121 N.W.2d 744 (1963).

113. *Id.* at 1003-04, 236 N.W.2d at 230.

114. *Id.*, 236 N.W.2d at 231.

IV. WARRANTIES

Finally, in *Mulvaney v. Tri State Truck & Auto Body, Inc.*,[115] the court held that the transfer of a certificate of title to a vehicle carried with it a warranty of title which could not be modified or excluded by agreement.

The plaintiff brought this action to recover damages sustained as a result of the defendant's breach of warranty of title to an automobile sold to the plaintiff by the defendant when it was discovered that the vehicle had been stolen. The defendant testified that he had obtained the vehicle through a newspaper advertisement from an out-of-state source. The defendant claimed to have informed the plaintiff of this, and of the fact that the odometer reading consequently could not be verified. The plaintiff had the title checked by the bank supplying the purchase money and was assured by it that the title was valid and unencumbered. Finally, the defendant tendered to the plaintiff a certificate of title bearing the warning, "This Vehicle May Be Subject To An Undisclosed Security Interest," and warned the plaintiff that no warranty of title could be made.[116]

The court concluded that no such modification or exclusion of warranty would be valid. Section 342.15(1) of the Wisconsin Statutes[117] requires the seller of an automobile to warrant its title, and the certificate of title in this case bore the language, "For value received I (We) hereby sell, transfer and assign the vehicle and warrant title to said vehicle described on this certificate."[118] The statute, the court reasoned, was intended to further the public policy of protecting purchasers of goods so easily the subject of fraudulent sales.[119] The requirement that the warranty follow the transfer of a vehicle's certificate of title was not negated by the warning that the vehicle might be subject to an undisclosed security interest.[120]

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115. 70 Wis. 2d 760, 235 N.W.2d 460 (1975).

116. *Id.* at 761-63, 235 N.W.2d at 462.

117. WIS. STAT. § 345.15(1) (1973) provides:

> If an owner transfers his interest in a vehicle, other than by the creation of a security interest, he shall at the time of the delivery of the vehicle, execute an assignment and warranty to title to the transferee in the space provided therefore on the certificate. . . .

118. 70 Wis. 2d at 763, 235 N.W.2d at 463.

119. *Id.* at 764, 235 N.W.2d at 463.

120. The court stated: "The distinctive certificate that warns of possible undisclosed security interests, which is normally issued for vehicles with titles from other states, does not negate the warranty. It merely offers a warning that a security interest may exist, irrespective of the beliefs of the seller." *Id.* at 767, 235 N.W.2d at 464.

Moreover, the court held that once the certificate of title is passed the warranty provisions of chapter 342 of the Wisconsin Statutes preclude the application of the Uniform Commercial Code with respect to a warranty exclusion. The transfer of an interest in an automobile may precede the conveyance of the certificate, and under these circumstances the Uniform Commercial Code and its warranties would be applicable.[121] But once the certificate of title is transferred, the Code no longer applies and the seller is held to the warranty required by section 342.15(1).[122]

This conclusion, while consonant with the intendment of the Wisconsin Vehicle Code, nonetheless introduces the possibility of an automobile purchaser being left in the very situation the statute attempts to avoid. For example, if the title certificate to the automobile is withheld by the seller even after delivery of the automobile, the purchaser is protected only if the seller's warranty of title under section 402.401 of the Commercial Code has not been modified or excluded.

DAVID B. BILLING

CRIMINAL JUSTICE

I. PRE-TRIAL STAGE

Since the decision was rendered, *Hadley v. State*[1] has been used extensively to successfully argue denial of the constitutional right to a speedy trial based on the *Barker v. Wingo*[2] test. *Foster v. State*[3] began the predictable trend to narrow the scope of *Hadley*. In *Foster*, the defendant was arraigned on two felony charges on April 26, 1971. Trial was set for May 27, 1971, but was adjourned by stipulation, and the defendant specifically

121. *Id.* at 765, 235 N.W.2d at 463.
122. *Id.* at 766, 235 N.W.2d at 464.

1. 66 Wis. 2d 350, 225 N.W.2d 461 (1975).
2. 407 U.S. 514 (1972). In *Barker* the court noted that a defendant's constitutional right to speedy trial can be determined only on an ad hoc basis in which the conduct of the prosecution and the defendant are weighed and balanced. Among factors which courts should assess in determining whether a particular defendant has been deprived of his right are length of delay, the reason for the delay, the defendant's assertion of his right, and prejudice to the defendant.
3. 70 Wis. 2d 72, 233 N.W.2d 411 (1975).